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Agenda Item 5

May 16, 2011

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. **SUBJECT:** Long-Term Care (LTC) Investment Annual Update and Strategic Asset Allocation
- II. **PROGRAM:** Affiliate Investment Programs Division
- III. **RECOMMENDATION:** Staff recommends the Investment Committee adopt either Portfolio 2, 3, or 4 of Attachment 1, page 9 as the policy portfolio.

Wilshire's opinion letter is included as Attachment 2.

IV. ANALYSIS:

Background

CalPERS is responsible for the administration, program design and premium rate setting of the Long-Term Care Program (the Program), which provides nursing home and in-home care benefits to enrolled members. CalPERS has offered this self-funded, voluntary Program since 1995. Member policies include a variety of options with varying degrees of daily benefit and total coverage amounts. All policies include a waiver of premium benefit and are guaranteed renewable.

As of June 30, 2010, there were a total of 159,571 policyholders with 4,883 members receiving benefits. In dollar terms, this equates to a total of \$285.9 million paid in premiums and \$133.0 million paid in claims for the one-year period ended June 30, 2010. The Program has been closed to new applicants since July, 2008.

Responsibilities

The Health Benefits Committee sets premium rates and approves program design. The CalPERS Investment Committee sets asset allocation and manages the assets.

Premium Rates

At the December 15, 2009 Health Benefits Committee meeting, the Committee approved, and the Board later approved, a staff recommendation to increase premiums ranging from 15 to 22 percent, depending on the policy type, effective July 1, 2010. In addition, the original product series (LTC1) is subject to annual 5 percent premium rate increases beginning July 1, 2011. The need for future premium increases will be reviewed and assessed during the 2014 annual valuation review.

Program Design Review

Over the next year, Health Benefit Program staff will be engaged in several activities:

- Issue a Request For Proposal for a third party administrator for the Program
- Assess and develop a restructuring plan for the Program
- Present Program plan recommendations to the Health Benefits Committee

Given this schedule, the current Long-Term Care Fund (the Fund) asset allocation review is short-term. Staff is requesting that the Investment Committee review and adopt an interim one-year policy portfolio for the Fund. Investment Office staff will return to the Investment Committee in one year to reassess the appropriateness of the policy portfolio given the program changes, funded status, and capital market conditions.

Fund Performance

The Fund is managed by CalPERS Investment staff. Since inception, the Fund has outperformed its benchmark by 0.06% as shown below.

Periods Ended 3/31/11 (gross)	Mkt Value \$(000)	Qtr	1 Year	3 Year	Annualized		ITD	Inception
					5 Year	10 Year		
LTC Fund	3,191,847	3.56	12.76	4.56	5.15	5.61	7.19	3/1/1996
LTC Policy Index		3.33	12.62	4.35	5.04	5.45	7.13	
Excess Return		0.23	0.14	0.21	0.11	0.16	0.06	

Source: State Street Bank. Note: The LTC Policy Index is a composite benchmark composed of the underlying asset class benchmarks weighted by asset class policy targets.

Asset Allocation Policy

The Fund is invested according to a strategic asset allocation policy approved by the Investment Committee, which has changed three times since inception of the Fund to a more diversified, less volatile mix as shown below.

CalPERS Long-Term Care Fund
Asset Allocation Policy History

	<u>4/15/96</u>	<u>9/17/02</u>	<u>3/14/05</u>
U.S. Equity	52%	42%	29%
International Equity	10%	20%	19%
Total Equity	62%	62%	48%
U.S. Fixed Income	37%	37%	30%
U.S. High Yield Bonds			10%
Treasury Inflation Protected Securities (TIPs)			7%
Cash Equivalents	1%	1%	0%
Total Fixed	38%	38%	47%
Global Real Estate Investment Trusts (REITs)			5%
TOTALS:	100%	100%	100%

Attachment 1, page 9 shows the current LTC Fund policy portfolio and nine alternative portfolios and characteristics of each. These portfolios are based on capital market assumptions from the Board's November 8 and 9, 2010 asset liability management (ALM) workshop. Staff will present this analysis at the May Investment Committee meeting.

Staff recommends that the LTC Fund policy portfolio continue to be more conservative than the PERF because the LTC Program is approximately fully funded, contributions consist entirely of member premiums, and there is less use of smoothing on member contributions. These considerations suggest that either Portfolio 2, 3, or 4 would be suitable.

V. STRATEGIC PLAN:

These initiatives address two CalPERS Strategic Plan Goals.

- Goal VIII to manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions; and
- Goal IX to achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

This review of the Long-Term Care Fund asset allocation strategy follows the recent strategy reviews for the California Employers' Retiree Benefit Trust, Legislators' Retirement System, and Judges' Retirement System II. Adoption of a new policy portfolio will result in some transaction costs, though these costs are expected to be small relative to the benefits.

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